

Internal Revenue Service

**memorandum**

CC:TL

Br4:JTChalhoub

date: April 30, 1986

to: David N. Brodsky  
Special Trial Attorney, Boston NA:BOS

from: Director, Tax Litigation Division CC:TL

subject: [REDACTED]

This is in reply to your request for technical advice, dated March 21, 1986, involving the subject petitioner.

ISSUE

Whether the tentative investment credit allowances previously accounted for in computing the deficiencies in the notice of deficiency for [REDACTED] and [REDACTED] should now be recaptured by a summary assessment under I.R.C. § 6213(b)(3)? 6213.07-02.

CONCLUSION

This will confirm our informal technical advice that the appropriate course of action, in the present posture of this case, is to make a summary assessment under I.R.C. § 6213(b)(3) of the excess investment tax credits previously allowed and paid to the taxpayer under I.R.C. § 6411. The amounts of the proposed assessments are \$ [REDACTED] plus interest for the tax year [REDACTED] and \$ [REDACTED] plus interest for the tax year [REDACTED].

If the taxpayer elects to pay the summary assessment, it may then file a motion for leave to amend its pleadings in the Tax Court case to claim an overpayment. We recommend that opposing counsel be contacted and the taxpayer be informed of the assessment by notice and demand as soon as practicable within the meaning of I.R.C. § 6303. Opposing Counsel should also be informed that the Service will listen to and consider any alternatives to payment of the assessment that might be suggested, if the alternatives do not endanger protection of the fisc or cause respondent to assume a burden of proof in this litigation. We have considered other ways in which the matter might be handled, as discussed herein, but do not believe them to be satisfactory solutions.

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FACTS

The taxpayer and its consolidated subsidiaries underwent an income tax examination for the tax years [REDACTED] and [REDACTED]. A notice of deficiency was prepared and issued pursuant to that examination. For [REDACTED] the notice of deficiency proposes a deficiency of \$[REDACTED]. For [REDACTED] the proposed deficiency is \$[REDACTED]. At the time the notice was issued on [REDACTED] the examiners were aware that the taxpayer had filed and had been granted tentative allowances under I.R.C. § 6411 with respect to certain investment credits carried back from [REDACTED] and [REDACTED]. For whatever reasons, the examiners did not audit the taxpayer and its consolidated subsidiaries with respect to their entitlement to the tentative allowances from [REDACTED] and [REDACTED] prior to issuing such notice of deficiency. The tax years [REDACTED] and [REDACTED] are presently before the Tax Court with respect to the deficiencies determined for those years.

The notice of deficiency includes the following references to such tentative allowances:

Investment tax credit is increased to \$[REDACTED] from \$[REDACTED] for the tax year [REDACTED]. Investment tax credit is increased to \$[REDACTED] from \$[REDACTED] for tax year [REDACTED]. The [REDACTED] amount includes carrybacks of \$[REDACTED] from the tax year [REDACTED] and \$[REDACTED] from the tax year [REDACTED]. These amounts are allowed tentatively subject to the examination of the [REDACTED] and [REDACTED] tax years.

\* \* \* \* \*

Tax from recomputing prior year investment credit is increased to \$[REDACTED] from \$[REDACTED] for tax year [REDACTED] and increased to \$[REDACTED] from \$[REDACTED] for tax year [REDACTED]. [S/N p. 3]

The carryback in the amount of \$[REDACTED] from tax year [REDACTED] to tax year [REDACTED] is allowed tentatively, subject to examination of the [REDACTED] year.

The carryback in the amount of \$[REDACTED] from tax year [REDACTED] to tax year [REDACTED] is allowed tentatively, subject to examination of the [REDACTED] year. [S/N/ p. 9]

At the time of your memorandum to this office, the audit team assigned to the taxpayer's [REDACTED] and [REDACTED] years is in the process of completing its examination of those years. Proposed unagreed adjustments of approximately \$[REDACTED] could wipe out the tentative refunds relating to the [REDACTED] and [REDACTED] carrybacks to [REDACTED] and [REDACTED], respectively.

Form 1120 for [REDACTED] for the [REDACTED] year was filed on [REDACTED]. The [REDACTED] Form 1120 was filed on [REDACTED]. The statute of limitations for the [REDACTED] and [REDACTED] years has been extended to [REDACTED].

Form 1139 - Application for a tentative carryback was filed on [REDACTED], for the tax year [REDACTED] in the amount of \$[REDACTED] to be carried back to [REDACTED]. The Form 1139 for [REDACTED] to be carried back to [REDACTED] in the amount of \$[REDACTED] was filed on [REDACTED]. The tentative carrybacks, plus interest, were allowed within the appropriate period prescribed by I.R.C. § 6411(b).

Although tentative amounts are referred to in the notice of deficiency, the effect of such references is treatment as a rebate in the computation of the deficiency for each year under I.R.C. § 6211. Consequently, the taxpayer did not need to raise, and did not raise, any issue with respect to such carrybacks in the petition. The only issue raised on the merits in the petition for both taxable years is the proper treatment of customer security deposits and when they should be included in income. Your request for technical advice is limited to the issue of recapture of excess investment tax credits carried back and tentatively refunded.

#### DISCUSSION

[REDACTED]

[REDACTED]

[REDACTED]

Under Midland Mortgage Co. v. Commissioner, 73 T.C. 902 (1980), the Tax Court held there were three methods available to recapture an excess carryback that has been refunded under I.R.C. § 6411. The three methods are: (1) inclusion of the disallowance in the notice of deficiency; (2) a summary assessment under I.R.C. § 6213(b)(3); and (3) a suit for erroneous refund under I.R.C. § 7405. Since the taxpayer is presently in the Tax Court with respect to the carryback years, method number (1) is no longer a viable option. Method number (3), although usually available, is not, in the circumstances of this case, a viable option, because it requires the Commissioner to assume a burden of proving the ITC carrybacks should be disallowed. You have indicated it is extremely important that the Commissioner not be required to assume a burden of proof on this issue. A fourth option, because the case is already in the Tax Court, has also been disregarded. The Commissioner could claim an increased deficiency under I.R.C. § 6214(a). That option also requires our assumption of the burden of proof. Tax Ct. R. 142(a).

That leaves option number (2) as the most viable method. However, the use of option number (2) is not without certain hazards that should be considered. A summary assessment is usually followed by a demand for payment. When interest is added to the amount of the total credit recapture for [REDACTED] and [REDACTED], \$ [REDACTED] the taxpayer will be asked to pay over [REDACTED] dollars. Even a corporation as large as this taxpayer may have difficulty in making so large a payment on notice and demand within 10 days.

Discussions should be initiated with taxpayer's counsel to keep the corporation fully informed. We believe the taxpayer has several options. We suggest that only options which include protection of the fisc be discussed unless the taxpayer's counsel raises them initially. First, the taxpayer could pay the assessment, including interest, and, after complying with the statutory requirements, could file a suit for refund in a district court or in the United States Claims Court. This could result in concurrent jurisdiction in two courts with respect to the tax liability of the taxpayer for the same tax years. This duality seems neither fair nor desirable. Secondly, the

taxpayer could decide to pay the assessment on notice and demand and move to amend its petition in the Tax Court case, to raise the issue that it is entitled to certain carryback credits which have been assessed under I.R.C. § 6213(b)(3). We should encourage the taxpayer to elect this option, because it allows the Tax Court to assume complete jurisdiction over the tax years [redacted] and [redacted].

A third option, is to first litigate or settle the Tax Court case without the investment tax credit carryback being raised or litigated as an issue. Upon disposition of the Tax Court case as a final decision, the taxpayer, having paid the assessment for one year or both years, would file suit for refund on the ground that the Tax Court decision was res judicata with respect to the tax liability for those years. It is certainly arguable whether the reference to a tentative allowance in the notice of deficiency has the effect of making the Tax Court's decision res judicata with respect to such matters. We know respondent failed to raise the issue by disallowance in the notice of deficiency and respondent does not wish to amend the answer to claim an increased deficiency. It is axiomatic that issues which could have been raised in prior litigation between the parties are deemed conceded and encompassed in the disposition of the prior litigation. Accord Tax Ct. Rule 34(b)(4). See e.g. Fluor v. United States, 79-1 U.S.T.C. 9393 (D.C. C.D. Cal. 1979) and Hanson Clutch & Machinery Co. v. United States, 72-1 U.S.T.C. 9303 (N.D. W.D. Ohio 1972). The district courts have held it is a question of fact whether the prior litigation included or subsumed the issue of an entitlement to a carryback.

A taxpayer is protected from the bar of res judicata with respect to a prior Tax Court decision in which a carryback issue was neither raised nor litigated. I.R.C. § 6511(d)(2), etc. The Commissioner has no such protection. That is, in large measure, why O.M. 19801 recommends that the notice of deficiency should await a determination with respect to the source year for the carryback. Unless the Service is prepared to assume the burden of proof, which it might have to do in the usual fact situation presented herein, a saving statutory feature is the Service's right to recapture a carryback by summary assessment to be followed by subsequent payment. Assessment and payment may provide a sufficient incentive to the taxpayer to formally raise the carryback issue in the open Tax Court case. We certainly recommend that option be pursued vigorously.

In addition to options involving payment of the summary assessment, including interest, the taxpayer has other options which must be considered. For example, it can refuse to pay the assessment. The Commissioner could be forced to use levy and distraint on the taxpayer's assets. An undesirable, but possible side effect of such an option, because of the substantial amounts involved, could be a bankruptcy or

reorganization proceeding. Again, this could mean the merits of a substantive tax issue, the ITC carrybacks, could be litigated in a bankruptcy court while other aspects of [REDACTED] and [REDACTED] liability are before the Tax Court.

We are uncertain and it is arguable whether the Tax Court could take jurisdiction of the ITC carryback issues, if the taxpayer did not pay the assessment first and plead entitlement to an overpayment. The jurisdiction of the Tax Court, generally, involves a decision on the merits with one or more of the following results for each taxable year: (1) a deficiency (statutory or otherwise); (2) an overpayment; (3) a deficiency (statutory), but an overpayment in fact (I.R.C. § 6512(b)(1)); (4) no deficiency and no overpayment. Consequently, we are reluctant to suggest to the taxpayer that it amend its petition to raise the issue of the ITC carrybacks without first paying the tax, even if we could postpone the payment of interest. The theory would be the Tax Court could take jurisdiction of issues involving tax liability, but could not take jurisdiction with respect to statutory interest.

The ideal solution would be for the district director to postpone collection of both tax and interest indefinitely, if it would not endanger the fisc. This would put the parties in the Tax Court suit in exactly the same position (including the burden of proof) as if the Commissioner had disallowed the carrybacks in the notice of deficiency and the taxpayer had raised the issue in the original petition. The only difference would be an assessment on the books, with the same characteristics as there would be in the case of jeopardy. Another difference would be to require execution of a Form 900 consent to extend the statute of limitations on collection, because I.R.C. § 6503(a)(1) did not suspend the statute of limitations on assessment or collection with respect to the carrybacks.

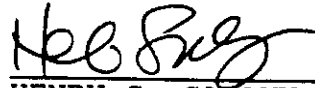
We have not located any case authority specifically on point that permits a taxpayer to raise an issue such as this without claiming an overpayment. However, we believe the Tax Court generally has jurisdiction to consider any issue that relates to a redetermination of the correct tax for any year covered by a valid notice of deficiency and a timely petition to the Tax Court. This option should permit the Commissioner to refrain from collecting the assessment until the litigation has terminated and all appeals, if any, have been exhausted.

If your research, or your discussions with opposing counsel, suggest any authority to get the ITC carryback issue before the Tax Court without requiring the tax first be paid and protecting

the fisc, please telephone Joseph T. Chalhoub, at FTS 566-3345, who will provide you with informal technical advice after reviewing such authority.

ROBERT P. RUWE  
Director

By:



HENRY G. SALAMY  
Chief, Branch No. 4  
Tax Litigation Division

Attachment:  
Copy of O.M. 19801

JTC/kyj/4/29/86